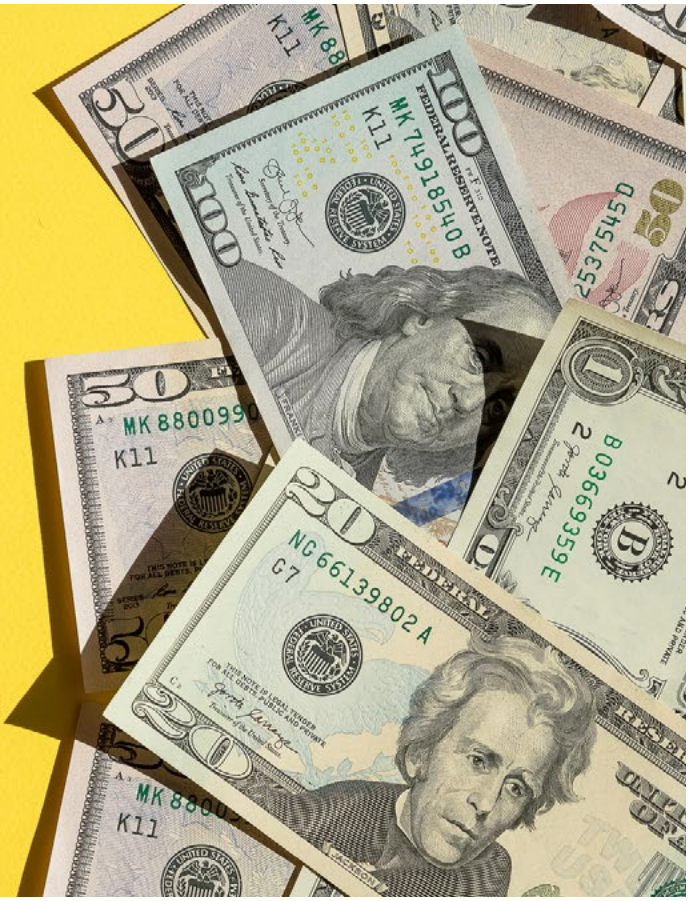
FIDUCIARY BEST PRACTICES PART II: ESTABLISH A PRUDENT PROCESS FOR SELECTING SERVICE PROVIDERS AND ASSESSING FEES



Written By Alston & Bird Health Benefits Practice

In last month's article on best fiduciary form, we considered best practices for establishing a health and welfare committee to oversee plan administration in light of fiduciary duties under the Employee Retirement Income Security Act (ERISA). Once you have established a fiduciary committee and have monitored your service providers, what should you do if the committee finds some of the providers to be lacking? Even if you are satisfied with your service provider, do you periodically conduct an RFP to see if the service provider is still the best value for the plan? Does your RFP break down questions about fees in order to make comparisons more easily? This month, we look at some best practices for selecting a new service provider and comparing provider fees.

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By way of review, last month we noted that ERISA imposes a duty of prudence and a duty of loyalty on fiduciaries, as well as an implied duty to monitor service providers to whom fiduciary responsibilities have been delegated. The duty of prudence focuses on the process, not on the outcome. Fiduciaries may not always know if they made the right choice, but the outcome can be defended if the process is prudent and well-documented. The uptick in litigation against health and welfare plan fiduciaries includes not just allegations of breaches in fiduciary duties but also allegations of prohibited transactions when service provider fees appear unreasonable.

SELECTING A SERVICE PROVIDER

When selecting a new service provider, or even when re-assessing an existing provider, the following best practices should be incorporated into the process:

- **Variety of Proposals**. A prudent process should be competitive and should obtain information from more than one provider—ideally, at least three. Brokers, consultants, attorneys, and other professionals who service your plan can provide recommendations, as well as chambers of commerce, industry associations for certain types of providers, and trade publications. Be aware, however, of relying too readily on the recommendations of brokers or consultants who may have financial arrangements or ties to a particular provider. When receiving a recommendation from, for example, a broker or consultant, always ask if compensation of any kind, either direct or indirect, would be exchanged between the broker or consultant and the provider.
- **Provide Identical Data.** All competing providers should have the same information about the plan and be asked about the same services needed. Include enough information about your own plan for the provider to respond meaningfully. Examples include:
    - funding method (e.g., insured or self-insured, stop-loss, VEBA, trust)
    - plan size
    - complexity and plan design (e.g., controlled groups, participating employers, integrated HRAs, carve-out specialty drug program)
    - expected fiduciary status of the provider (if any)
    - any other features that may deviate from a standard plan that may require special services or experience on the part of the provider
- **Keep a Level Playing Field.** Evaluating responses from competitors will be much easier if decisions are based on the same information, such as services offered, experience, and costs. Consider the format of the RFP as well. For example, an RFP in grid format with specific, pointed questions and limited space for responses will discourage generic responses (or at least make them easier to spot) and enable you to create a side-by-side comparison of responses from each provider. Although there will be some advantages to remaining with the same service provider, try to evaluate all competitors based on the responses in the RFP.
- **Provider History.** Ask providers about their history (e.g., what their corporate structure is, how long they have been in business, who their predecessor is), and whether any mergers or acquisitions are underway that can be disclosed. Require a provider to submit information about its financial condition (e.g., leverage, loans, debt, and bankruptcies) and its experience with health plans like yours. The more detailed information you can provide about the plan, the more helpful the

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provider response will be in comparing the capacities and abilities of various providers. Also, ask if the service provider locks its client into other relationships with specific providers (e.g., banks or insurers).

- **Review the Quality of the Provider.** Carefully examine information about the quality of the service provider, even providers that previously or currently service your plans. Examples of what to ask include:
    - Who will be providing services, and what is their experience and qualifications;
    - What is the turnover rate of the employees who will be providing the services;
    - Does the provider use subcontractors, and if so, does the provider guarantee and indemnify the work of the subcontractor;
    - What are the provider's data feed and IT requirements or limitations with respect to the data that will be routinely shared between the plan and the provider (or between the plan's other service providers that may share data with the provider);
    - Any recent litigation or enforcement action taken against the provider;
    - Any recent litigation in which they have been named, even if not as a defendant, as providing services to a defendant accused of breaches of fiduciary duty or prohibited transactions;

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- The provider's experience or performance record, including whether it offers performance guarantees;
- Customer service access and procedures to promptly address and resolve participant questions and complaints;
- Where are the employees providing the services located, and what kinds of disaster plans and backup plans are in place for the services;
- Data confidentiality (including HIPAA) processes and procedures, including cybersecurity and any breach incidents;
- Does the provider use artificial intelligence in its provision of services, and if so, how;
- Participant satisfaction reports or statistics;
- Require assurances that any required licenses, ratings or accreditations are up to date (insurers, brokers, TPAs, healthcare service providers)
- Require assurances for liability insurance, including cybersecurity, in appropriate amounts.

- **Document the Selection Process.** The statute of limitations for a breach of fiduciary duty is six years. The plan may have changed providers within that time, or key personnel at your organization involved in the selection process may no longer be working for you. Document the selection (and monitoring) process, and, when using an internal administrative committee, educate committee members on their roles and responsibilities. Increased litigation in this area focuses on provider fees, so documentation may be especially important if the provider with the lowest fees is not chosen.

ASSESSING THE REASONABLENESS OF PROVIDER FEES

The reasonableness of fees is an important consideration for fiduciaries because agreements with service providers may be a prohibited transaction if the plan is paying exorbitant fees. ERISA §406(a)(1) prohibits a fiduciary from causing a plan to engage in a transaction that involves the exchange of goods or services between the plan and a party in interest, but the statutory exemption at ERISA §408(b)(2) allows plans to enter into contracts with services providers, so long as the exemption requirements are met. Two of the key exemption requirements are (1) that the arrangement itself be reasonable and (2) that provider compensation be reasonable. A prudent fiduciary does not need to choose the lowest-cost provider but does need to explain (and document) the reasoning for choosing a higher-cost provider.

Given the complexity of fee arrangements, it may be difficult to make apples-to-apples comparisons of fees. When drafting questions for the RFP, try to be as pointed as possible and hire an expert to help with drafting if the plan does not have any in-house experts in a given area. For example, it may be difficult, if not impossible, to compare the fees of two providers when those fees are based, in part, on "shared savings," especially if each provider defines "shared savings" differently. Pricing for PBM services and prescription drugs can also be difficult to understand. An expert in PBM pricing may be able to incorporate questions into the RFP that get at issues specific to PBM pricing, such as benchmarks for pricing prescription drugs, how rebates are defined, and when rebates are credited back to the plan.

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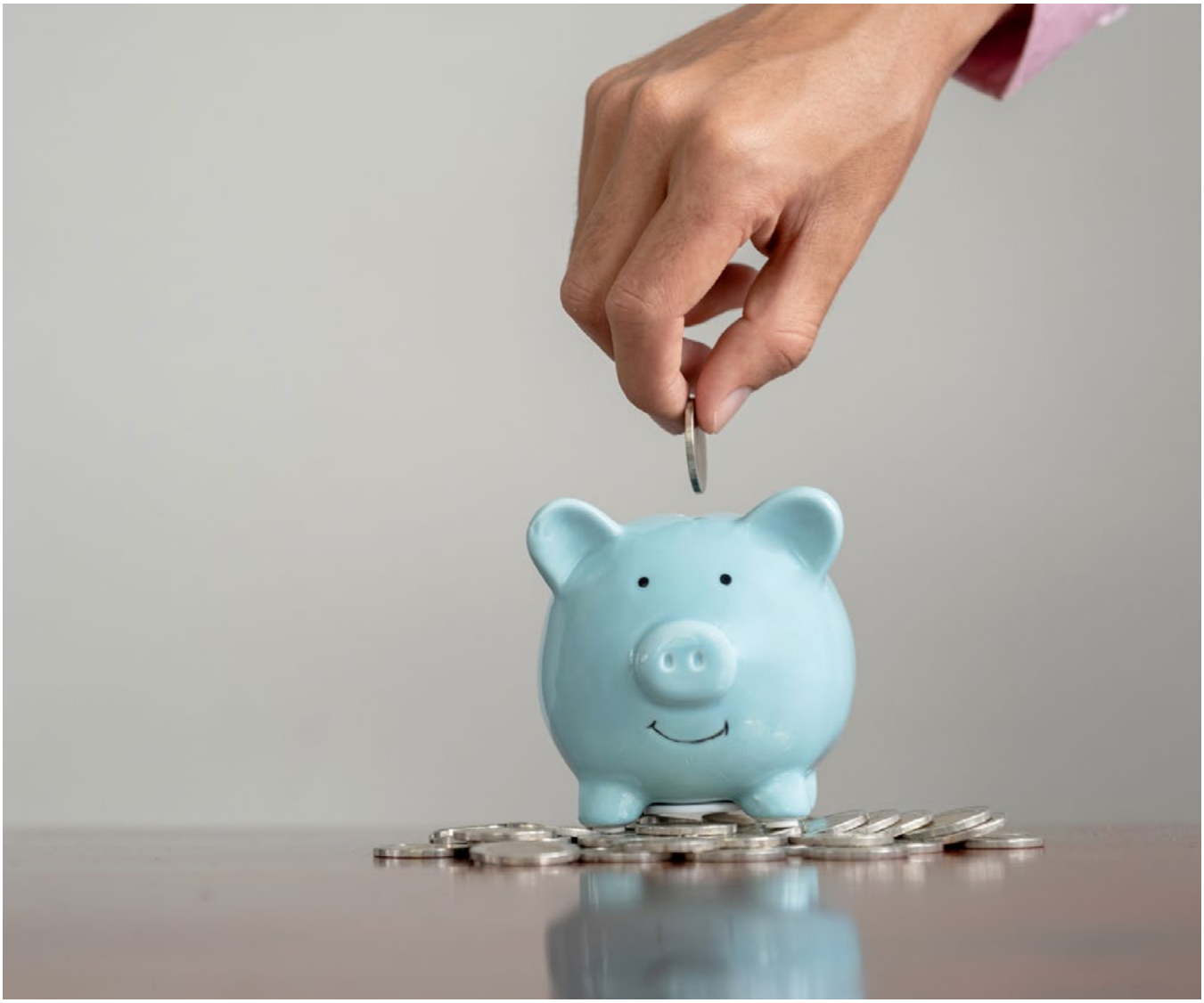
Below are some general topics to consider addressing in your RFP regarding provider fees:

- Get a proper breakdown of fees based on services requested. When comparing estimates from prospective service providers, ask which services the estimated fees cover and which they do not. Take into account "bundled" service arrangement versus separate charges for individual services. Be mindful of hard-to-quantify services fees, such as fees based on litigation or subrogation recoveries or "shared savings."
- Compare all services to be provided with the total cost for each provider. Some providers may be more expensive than others, but their fees may include higher levels of the same type of services. This should be documented in any decision that takes higher-level services (and high fees) into account.
- Consider whether the fee estimate includes services that were not requested or are not wanted.
- Ask about differences in fees for different arrangements. For example, in an RFP for a PBM, ask for estimates based on a traditional PBM model, pass-through model, and carve-out for specialty drugs.



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Also, ask if provider fees (and not just drug prices) would be different based on which benchmark is used for drug pricing (e.g., AWP versus NADAC). As noted above, input from an expert would be helpful.

- Include important or non-negotiable defined terms that may impact provider fees. For example, include a definition for "rebates" in an RFP for PBMs and ask if the PBM can agree to use the definition in the service agreement without any change to the proposed fees.
- If not covered under the Consolidated Appropriation Act's ERISA §408(b)(2) disclosures, ask prospective providers whether they receive any third-party compensation, such as finder's fees, commissions, or revenue sharing. (Note: also establish a process to regularly monitor plan fees for reasonableness.)
- Look at payments to subcontractors and any related parties.
- Get confirmation from the provider that early termination without penalty will be part of the service agreement. (This is an ERISA requirement)

AUDIT RIGHTS ALONE ARE NOT ENOUGH

Self-insured plans need to audit their service providers regularly in order to ensure that services are properly provided and fees are properly calculated. Audit rights alone may not guarantee a plan's ability to thoroughly and efficiently monitor a provider. Some providers include restrictions on which auditors can be used, limit audit rights to a small sample size, and limit audit rights after termination of the agreement. Make sure certain potentially "deal-breaking" audit requirements are included in the terms of the RFP itself. Insist on audit rights that provide enough sampling to determine whether the provider is adhering to the service agreement. Exercise these audit rights and document. Be mindful of audit provisions that limit access, frequency, or post-termination access to plan information or that limit the plan's choice of auditor. Also, be mindful of audit provisions that give the provider the right to review and approve the audit report before the plan sees the report.

HOW OFTEN DOES A PLAN NEED TO CONDUCT AN RFP?

Currently, there are no rules or cases that set forth any guidelines on how often fiduciaries of a health and welfare plan need to conduct an RFP. A best practice would be to conduct an RFP every few years to compare available pricing options and service providers. Plans understandably get comfortable with specific providers who have come to know their plan well over the years, but fiduciaries still have a duty to review these arrangements and document their reasons for continuing to use a specific provider. Using a consultant to benchmark fees may also be helpful at regular intervals, but conducting an RFP from time to time may provide more relevant, accurate, and meaningful data for purposes of evaluation and comparison.

KEY TAKEAWAYS:

Remember, demonstrating a prudent process, not the "best" outcome in hindsight, will generally satisfy the duty of prudence. Some best practices for the prudent selection of a service provider include:

- Include a variety of providers in the RFP.
- Provide identical data about the plan to each provider.

- Create a level playing field by tailoring your questions to elicit specific, rather than generic, responses.
- Collect information on provider history and the quality of the provider.
- Draft the RFP to break down the fees into their most basic elements and hire an expert to assist with this drafting if necessary.
- Include dealbreaker terms in the RFP, including audit rights and key definitions.
- Document the entire selection process. ■

About the Authors

Attorneys John Hickman, Ashley Gillihan, Steven Mindy, Ken Johnson, Amy Heppner, and Laurie Kirkwood provide the answers in this column. John is partner in charge of the Health Benefits Practice with Alston & Bird, LLP, an Atlanta, New York, Los Angeles, Charlotte, Dallas and Washington, D.C. law firm. Ashley and Steven are partners in the practice, and Ken, Amy, and Laurie are senior members in the Health Benefits Practice. Answers are provided as general guidance on the subjects covered in the question and are not provided as legal advice to the questioner's situation. Any legal issues should be reviewed by your legal counsel to apply the law to the particular facts of your situation. Readers are encouraged to send questions by E-MAIL to John at john.hickman@alston.com.